THE ABCs OF Accounting

Lesson 3: Working with Debits and Credits

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Lesson Objectives

- After studying this lesson, you will be able to:
  - Explain the rules of debits and credits
  - Apply the rules of debits and credits
  - Use T accounts to analyze business transactions in their debit and credit parts
  - Test for the equality of debits and credits

Accounting

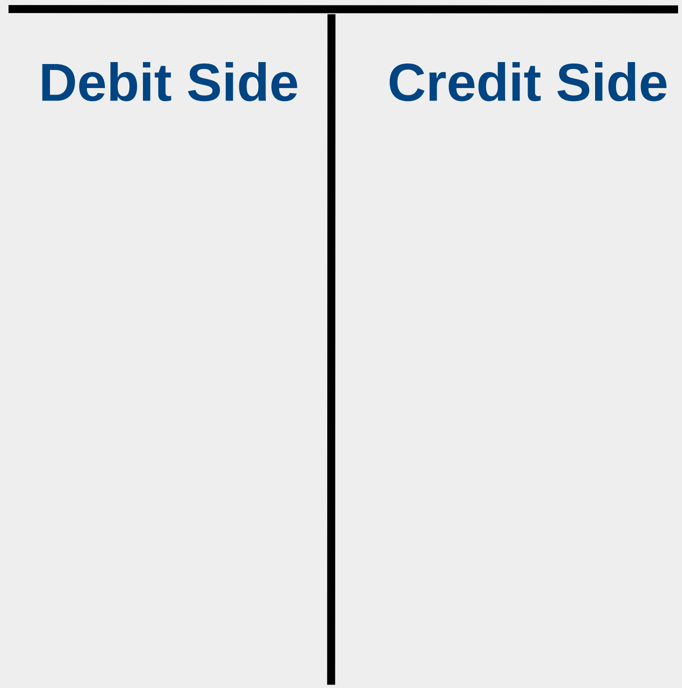
- Recordkeeping is a basic part of accounting
- Separate records are kept for assets, liabilities, and owner's equity
- When a business transaction occurs:
  - It affects two accounts
  - This is called double-entry bookkeeping because each transaction must be entered on two account sheets
  - You bought $20 worth of supplies:
    - Cash goes down $20
    - Supplies goes up $20

T Accounts

- Are used by accountants to analyze transactions
- You can group all transactions of a particular type to make recordkeeping simpler
- You don’t have to go to account sheets to record information

T Accounts

- A T Account looks like a T:
- Left side (debits) must always equal right side (credits)



T Accounts: The Accounting Equation

Assets = Liabilities + Owner's Equity

Assets		Liabilities		Owner's Equity	
+	-	-	+	-	+
Record Increases	Record Decreases	Record Decreases	Record Increases	Record Decreases	Record Increases

Working with the Rules of Debits and Credits

- Each T account has a left side and a right side
- The left side is used to enter *debit* amounts
- The right side is used to enter *credit* amounts
- Double-entry accounting:
  - When you make a debit entry in one account
  - You must make a credit entry for the same amount in another account

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Rules for Asset Accounts

- Asset account is increased (+) on debit side
- Asset account is decreased (-) on credit side
- *Normal balance* for an asset account is a debit balance

Assets	
+	-
Increase Normal Balance	Decrease

Rules for Liability & Owner's Equity Accounts

- Liability & capital accounts increased (+) on credit side
- Liability & capital accounts decreased (-) on debit side
- *Normal balance* for liability & capital accounts is a credit balance

Liabilities	
-	+
Record Decreases	Record Increases Normal Balance

The Rules of Debits and Credits for Temporary Capital Accounts

- Owner's Equity account shows what owner has invested
  - Increases when the business earns revenue or income
  - When the owner takes a withdrawal or there are business expenses, this account is decreased
- Accounts used to track this information are called:
  - Temporary Capital Accounts
  - Revenue, Expense, and Withdrawals

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Temporary Capital Accounts

- These accounts start each accounting period with a balance of zero.
- Utilities Expense account is used to track electricity, telephone, and Internet expenses. By using a separate account, Dave can see how much he is spending on utilities for a given period.
- Opposite of a temporary account is a permanent account (balances are carried forward):
  - Owner's Equity
  - Assets and Liabilities

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Rules for Revenue Accounts

- Revenue account is increased (+) on the credit side
- Revenue account is decreased (-) on the debit side
- *Normal balance* for a revenue account is a credit balance

Revenue	
Debit -	Credit +
Decrease	Increase Normal Balance

Rules for Expense Accounts

- Expense account is increased (+) on the debit side
- Expense account is decreased (-) on the credit side
- *Normal balance* for a expense account is a debit balance

Expense	
Debit +	Credit -
Record Increases Normal Balance	Record Decreases

Rules for Withdrawal Accounts

- Withdrawal account is increased (+) on the debit side
- Withdrawal account is decreased (-) on the credit side
- *Normal balance* for a withdrawal account is a debit balance

Owner's Withdrawal	
+	-
Record Increases Normal Balance	Record Decreases

Summary of Rules of Debits & Credits

Assets		Liabilities		Owner's Equity	
+	-	-	+	-	+
Record Increases Balance Side	Record Decreases	Record Decreases	Record Increases Balance Side	Record Decreases	Record Increases Balance Side

Owner's Withdrawal Account		Revenue Accounts		Expense Accounts	
+	-	-	+	+	-
Record Increases Balance Side	Record Decreases	Record Decreases	Record Increases Balance Side	Record Increases Balance Side	Record Decreases

The Trial Balance

- If the transactions are properly analyzed and recorded, the total debits should equal the total credits
- This is called, “The testing of the equality of the debits and credits”

Steps to Run the Test

1. Create T accounts
2. Enter transactions (make sure you have debit and credit entries)
3. Total each side
4. List account titles on a separate sheet of paper
5. List debit balances next to debit balance accounts
6. List credit balances
7. Add the columns

Deep Divers Trial Balance

Account Title	Debit Balance	Credit Balance
Cash	45,107.01	
Inventory	595.99	
Equipment	55,400.00	
Supplies	500.00	
Accounts Payable		23,500.00
David D., Capital		75,400.00
Boat Trip Fees		3,950.00
Advertising Expense	600.00	
Repair Expense	647.00	
Totals	102,850.00	102,850.00

Errors on the Trial Balance

- If debits equals credits, the financial records are in balance
- Common errors:
  - Was the column added correctly?
  - Was a transaction only partially entered?
  - Were both halves recorded as debits or credits?
  - Was there a transposition error? (Two numbers reversed)

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Summary

- Rules of debits and credits were learned
- T accounts were introduced and used
- Permanent accounts carry their balances forward
- Temporary capital accounts zero out each accounting period
- Revenue, expense, and withdrawal are examples of temporary capital accounts; they are part of the Owner's Capital account

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